Office of Chief Counsel
Internal Revenue Service

memorandum

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date: January 28, 2002

to: Compliance Division
Attn: Team Chief Steve Laurion, LMSB 1720

from: Associate Area Counsel (LMSB), Chicago

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subject: [redacted]
Validity of Election Under I.R.C. § 195

This memorandum responds to your request for advice dated December 18, 2001 (which we received on January 3, 2002) in which you ask whether an election to amortize start-up expenditures under I.R.C. § 195 which the taxpayer filed with its [redacted] income tax return is valid. In our opinion, the election is not valid.

We do not believe that this memorandum concerns an issue that requires coordination with an industry counsel.

This memorandum should not be cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

Facts

[redacted] (the taxpayer) is engaged in the [redacted] business. The taxpayer purchased a line of [redacted] products during [redacted] for some $[redacted]. In its returns for the year ended December 31, [redacted] and subsequent years the taxpayer treated this purchase as an intangible asset and claimed amortization deductions as provided in I.R.C. § 197. During [redacted] the taxpayer also acquired all of the stock of another corporation for some $[redacted]. The taxpayer treated this entire purchase as capital. The taxpayer did not claim any part of the cost of either asset as start-up expenditures on its return for [redacted], nor did that return claim any other deduction for start-up expenditures under I.R.C. § 195.

You are presently examining the taxpayer's [redacted] return. During this exam the taxpayer has proposed that part of the two acquisitions referred to above should be considered as start-up expenditures and be amortized as provided in I.R.C. § 195.

The taxpayer's return for [redacted] included an election under § 195. Beneath the taxpayers name, address, and identification number, the one-page election reads, in full, as follows:

YEAR ENDED: DECEMBER 31, [redacted]

ELECTION TO AMORTIZE START UP EXPENDITURES UNDER I.R.C. SECTION 195

> Pursuant to Section 195, the above named taxpayer and its subsidiaries hereby elect to amortize start up expenditures over a 60 month period.

In fact, the return does not claim any deductions for start-up expenditures, nor does the return contain any other mention of deductions for start-up expenditures.

Issue

Is the taxpayer's election to amortize start-up expenditures under I.R.C. § 195 valid when the election contains no description of the transaction or assets upon which the claim is based, no indication of the date on which such expenditures occurred, no mention of the dollar figures involved, and no deduction for start-up expenditures was actually claimed in the return?

Law

I.R.C. § 195(a) provides, as a general rule, that no deduction is allowed for start-up expenditures. "At the election of the taxpayer," however, I.R.C. § 195(b) provides that start-up expenditures may be deducted as prorated over a period of not less than 60 months.

I.R.C. § 195(d) states:

> (1) An election under subsection (b) shall be made not later than the time prescribed by law for filing the return for the taxable year in which the trade or business begins (including extensions thereof).

(2) The period elected under subsection (b) shall be adhered to in computing taxable income for the taxable year for which the election is made and all subsequent taxable years.

The Code does not contain any description of the required contents of this election.

Treas. Reg. § 1.195-1(b), (c), and (d) state:

(b) The election to amortize start-up expenditures under section 195 shall be made by attaching a statement containing the information described in paragraph (c) of this section to the taxpayer's return. The statement must be filed no later than the date prescribed by law for filing the return (including any extensions of time) for the taxable year in which the active trade or business begins . . .

(c) The statement shall set forth a description of the trade or business to which it relates with sufficient detail so that expenses relating to the trade or business can be identified properly for that taxable year in which the statement is filed and for all future taxable years to which it relates. The statement also shall include the number of months (not less than 60) over which the expenditures are to be amortized, and to the extent known at the time the statement is filed, a description of each start-up expenditure incurred (whether or not paid) and the month in which the active trade or business began (or was acquired). A revised statement may be filed to include any start-up expenditure not included in the taxpayer's original election statement, but the revised statement may not include any expenditures for which the taxpayer had previously taken a position on a return inconsistent with their treatment as start-up expenditures. The revised statement may be filed with a return filed after the return that contained the election.

(d) This section applies to elections filed on or after December 17, 1998.

Announcement 81-43, 1981-11 I.R.B. 52 (March 16, 1981), states, in part:

> To make the election [under I.R.C. § 195], the taxpayer should attach a statement to the return for the tax year in which the amortization period begins. The return and statement must be filed by the due date for filing the return (including any extensions of time). The statement must include the description and amount of the expenditures involved, the date the expenditures were incurred, the month in which the taxpayer began or acquired the business, and the number of months in the amortization period.

I.R.C. § 195 was enacted as part of the 1980 Miscellaneous Revenue Act (P.L. 96-605). The Senate Explanation of that act comments on the proposed I.R.C. § 195 as follows:

> Amortization elections generally must be made at the time, and in the manner, specified in Treasury regulations. . . . It is anticipated that election procedures will be similar to those used under sections 248 and 709 of the Code (relating to certain organization fees), and that elections may not be made on a conditional basis.

Rev. Rul. 99-23, 1999-1 C.B. 998, clarifies which expenses are "start-up expenditures" within the meaning of I.R.C. § 195. This revenue ruling makes no comment on the election procedure under that Code section.

Analysis

In our opinion, the election filed by the taxpayer does not satisfy the requirements of an election and is therefore not effective to claim amortized start-up expenditures under I.R.C. § 195.

When the taxpayer filed the election with its return for [redacted], Treas. Reg. § 1.195-1 had not yet been published. Furthermore, that regulation states on its face that it applies only to elections filed after December 17, 1998. That regulation therefore does not apply to this problem, although we will comment on the implications of that regulation later in this memorandum.

At the time the taxpayer filed its election, the Service's only published guidance on the sufficiency of a Section 195 election was Announcement 81-43. This announcement requires an election to state "the amount of the expenditures involved, the date the expenditures were incurred, the month in which the

taxpayer began or acquired the business, and the number of months in the amortization period." The election filed by the taxpayer contained none of this information except the number of months in the amortization period. The election was therefore insufficient. The announcement does not allow any exceptions.

The detailed requirements of Announcement 81-43 are supported by the Senate Committee Report produced during the process of enacting I.R.C. § 195 during 1980-81. That report states that a Section 195 election "may not be made on a conditional basis." An election such as the taxpayer's which does not describe any assets or transactions and which does not claim any § 195 deductions for the year at issue must be considered "protective," "blanket," or "conditional." It was not the intent of Congress to allow Section 195 amortization based on such an election.

The taxpayer argues that it should be allowed to claim § 195 treatment for the assets at issue by making a "revised election" as provided in Reg. § 1.195-1, despite the fact that the regulation states on its face that it applies only to original elections filed after December 17, 1998. Even if we apply that regulation, however, it does not support the taxpayer. Reg. § 1.195-1 requires the original election to contain a detailed statement very similar to that described in Announcement 81-43. Treas. Reg. § 1.195-1(c) provides a very limited exception to that rule. Under § 1.195-1(c), "a revised statement may be filed to include any start-up expenditure not included in the taxpayer's original election statement, but the revised statement may not include any expenditures for which the taxpayer had previously taken a position on a return inconsistent with their treatment as start-up expenditures." In order to apply this section, two requirements must be met: (1) The taxpayer must have filed an "original election statement," and (2) The taxpayer in his original return must have treated his revised additional start-up expenditures in a manner not inconsistent with I.R.C. § 195.

In the present case, it is not clear whether the taxpayer filed an original election statement. A purported election statement as devoid of information as the one filed by this taxpayer may be considered no election statement at all. If there is no original election then no revised statement is allowed under the Regulation.

Even if we grant that the taxpayer's blanket claim of § 195 coverage is a valid original election, the taxpayer did not in its return treat the additional start-up expenditures that it now claims in a manner consistent with § 195. Fifteen-year

amortization of intangible assets under I.R.C. § 197 is not consistent with 5-year amortization of start-up expenditures under § 195. The taxpayer's treatment of the corporate acquisition as capital assets with no amortization is not consistent with § 195 amortization. The taxpayer therefore cannot file a revised election statement to claim § 195 treatment for these items.

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The taxpayer argues that it should be allowed to claim § 195 treatment for the assets in question on the grounds that it would have been eligible for such treatment if it had made a timely election. We reject this argument. Most sections of the Internal Revenue Code do not require the filing of an election by the taxpayer in order to apply that section. For example, if a taxpayer files a return in which it neglects to claim a deduction for advertising expense which it has legitimately incurred, the Service, upon examining the return, must allow that deduction. That the taxpayer failed to claim the deduction on the return is not relevant. This is because I.R.C. § 162 (which allows deductions for all ordinary and necessary business expenses) does not require the taxpayer to file an election in order to be entitled for its benefits. As long as the taxpayer's failure to claim a legitimate business expense is discovered before the expiration of the statute of limitations, an adjustment can be made. Section 195 is different. In order to take advantage of the treatment provided in Section 195, the taxpayer must file a timely election. Unlike Section 162, the fact that the taxpayer would have been entitled to Section 195 treatment if it had filed the election is no excuse for failure to file an election.

The taxpayer also argues that it should be allowed § 195 treatment now because the taxpayer's original return treated the items at issue "conservatively,", i.e., the taxpayer would have had larger deductions if it had claimed § 195 treatment instead of the treatment it actually claimed in the return. The Regulation, however, is addressed only to "consistent" treatment and does not distinguish between original treatment which was more or less favorable to the taxpayer than § 195 treatment. Indeed, whenever a taxpayer claims § 195 treatment after filing

its return it will do so because such treatment is more favorable than the treatment claimed in the return. That the taxpayer's treatment in the return was "conservative" does not allow the taxpayer to file a late election or an inconsistent revised election.

The taxpayer refers to Farmers Grain Marketing Terminal v. United States, 434 F.Supp. 368 (1977), in support of its position. In that case, the taxpayer filed a timely election to amortize organizational expenditures over a 60-month period, as provided by I.R.C. § 248. The election and the return claimed such treatment for the $267.75 of organizational expenditures that had been billed during the taxpayer's initial year. The taxpayer had incurred and was entitled to claim such treatment for additional organizational expenses of $2,207.25. The taxpayer had neglected to include this amount in its election and return because of a bookkeeping error. The court held that the taxpayer could file an amended election to include the additional $2,207.25. That case was clearly distinguishable, however, from the present taxpayer's situation. In Farmers Grain Marketing the applicable regulation under § 248 required a detailed election but made no mention of amending such an election. The court determined that an amended election was allowed under limitations described by the court. This is different from the § 195 regulations, which specifically provide for a "revised election" procedure and therefore give the courts less leeway to determine when and how a revision can be made. More importantly, the original election in Farmers Grain Marketing was clearly a detailed, valid election and not a "blanket" election containing no information. The court specifically stated it may have found in the government's favor if the original election had been a blanket election. As the court put it:

> While defendant's [United States's] position would appear to be more cogent where a taxpayer has failed to comply with the stated regulation by completely omitting any organizational expenditures from the election statement, and subsequent to expiration of the time allowed, attempts to rectify such failure, that is not the situation here presented. When reduced to its essence, such a belated attempt would involve no more than an attempt to elect amortization after the statutory period allowed for that purpose has expired. Here, defendant does not argue that plaintiff's [original] election statement failed to comply with the applicable regulations. . . .

In our opinion, the taxpayer in the present case is attempting to do exactly what the court looked askance upon in Farmers Grain Marketing, i.e., electing amortization after the statutory period for filing an election to do so has expired by revising or amending a "blanket" election.

Finally, the taxpayer argues that in the absence of regulations under § 195, it was not clear to the taxpayer how and when to file an election. We find this argument unpersuasive. The Code section at issue was enacted in 1980. Many taxpayers have successfully filed elections since that time based on the instructions provided in Announcement 81-43 and in the Code itself. We have no reason to think that a well-informed taxpayer would be unable to file an appropriate and timely election.

It is worth noting that the Joint Committee Reviewer, (Volume 3, Issue 12, December, 2001) specifically addresses the topic of "blanket" Section 195 elections. It states that the "IRS will disallow these protective elections that are intended to become effective upon the IRS determination that start-up expenses were incurred. Any expenses so identified will be fully disallowed and not subject to amortization." Note also, however, that the Joint Committee Reviewer is for internal use only. Under no circumstances should the contents be used or cited as authority for setting or sustaining a technical position.

According to the revenue agent, the taxpayer has expressed the belief that Treasury Regulations are only an opinion by the Service and that the Compliance Division has considerable leeway in choosing whether to enforce them. Nothing could be further from the truth. Treasury Regulations are the product of a thorough and painstaking process which includes input from the public. They are given great weight. Only under the most extraordinary circumstances would the Service choose not to enforce a Regulation if the facts indicate that the Regulation applies. Such enforcement efforts would include litigation, if necessary.

Of course, this advice depends on the facts which you have presented and we caution you not to apply this advice to other taxpayers. If you have any questions or need further advice, please contact J. Paul Knap at 414-297-4246.

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